

Private foundations; self-dealing; incidental benefit to disqualified person. A loan program of a private foundation that provides financing to publicly supported organizations for construction projects in disadvantaged areas does not result in acts of self-dealing within the meaning of section 4941 of the Code merely because certain individuals involved in the construction projects have ordinary banking and business relationships with a bank that is a disqualified person.

#### ISSUE

The Internal Revenue Service has been asked whether the loan program of a private foundation that provides financing to publicly supported organizations for construction projects in disadvantaged areas results in acts of self-dealing within the meaning of section 4941 of the Internal Revenue Code because some contractors and subcontractors involved in the construction projects, their suppliers, and employees of those involved may have ordinary banking and business relationships with a bank that is a disqualified person.

#### FACTS

P is exempt from federal income tax under section 501(c)(3) of the Code, and is a private foundation within the meaning of section 509(a). B is a bank that is a disqualified person with respect to P within the meaning of section 4946.

In furtherance of its desire to support the revitalization of inner city areas suffering from blight and decay, P has entered into a master loan agreement with C, an organization that supports community development organization by furnishing assistance to them. C is exempt under section 501(c)(3) of the Code and is not a private foundation because it is described in section 170(b)(1)(A)(vi) and 509(a)(1).

Under the master loan agreement, P has extended an interest-free line of credit to C, which will re-lend the borrowed funds at substantially below-market interest rates to the community development organizations. Loans under this line of credit are program-related investments within the meaning of section 4944(c) of the Code. The master loan agreement requires that each community development organization must be described in section 501(c)(3) or 170(c)(1) of the Code, and must not be a private foundation under section 509.

Each community development organization uses the proceeds of its loan from C to purchase a certificate of deposit from a financial institution other than B or any disqualified person with respect to P. The purchase of the certificate of deposit facilitates acquisition of financing for construction of projects (primarily residential) in economically disadvantaged areas of

the United States. The master loan agreement provides that no construction or permanent financing will be provided by a disqualified person with respect to P. The master loan agreement also provides that P must approve in advance all of C's loans to community development organizations, and must disburse funds to C only as C disburses funds to such organizations.

Each community development organization has sole control over the selection of general contractors, subcontractors, and suppliers for its projects. Neither P nor any disqualified person with respect to P participates in such selection. Furthermore, loan proceeds are not to be set aside for, directed to, or conditioned upon, the use of contractors or suppliers selected by P or by any disqualified person with respect to P.

Some general contractors, subcontractors, suppliers, or their employees, however, may have ordinary banking or business relationship with B or its affiliates. However, no preferential treatment is accorded by reason of these relationships.

#### LAW AND ANALYSIS

Section 4941 of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Section 4941(d)(1)(E) provides that the term 'self-dealing' includes any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or the assets of a private foundation.

Section 53.4941(d)-2(f)(2) of the Foundation Excise Tax Regulations provides that the fact a disqualified person receives an incidental or tenuous benefit from the use of a foundation of its income or assets will not, of itself, make such use an act of self-dealing. This is illustrated by EXAMPLE (1) of section 53.4941(d)-2(f)(4), which considers a grant by a private foundation to the governing body of a city for the purpose of alleviating the slum conditions that exist in a particular neighborhood of a city. A corporation that is a substantial contributor to the foundation, and thus a disqualified person with respect to the foundation, is located in the same area in which the grant is to be used. Although the general improvement of the area may constitute an incidental or tenuous benefit to the corporation, such benefit by itself will not constitute an act of self-dealing under section 4941 of the Code.

Rev. Rul. 80-310, 1980-2 C.B. 319, concerns a grant made by a private foundation to an exempt university to establish an educational program providing instruction in manufacturing engineering. A corporation that is a disqualified person with respect to the private foundation intends to hire graduates of the new program and encourage its employees to enroll, but will not receive preferential treatment in recruiting graduates or enrolling its employees. Rev. Rul. 80-310 holds that the grant does not constitute an act of self-dealing within the meaning of

section 4941 of the Code because any benefit to the corporation is incidental.

In this case, as in the slum clearance program described in EXAMPLE (1) of section 53.4941(d)-2(f)(4) of the regulations, and as in the grant described in Rev. Rul. 80-310, providing financing for alleviating conditions in disadvantaged areas is a program of broad public interest. The loan agreement prohibits the community development organizations from purchasing certificates of deposit from B or any other disqualified person with respect to P; prohibits disqualified person with respect to P from providing construction or permanent financing; and provides that P and any disqualified person with respect to P will neither participate in the selection of contractors, subcontractors, or suppliers, nor influence such selection. Thus, if any benefit to B or some other disqualified person with respect to P would result from an ordinary banking and business relation with a contractor, subcontractor, supplier, or an employee of those parties in the described construction projects, such benefit would be incidental or tenuous within the contemplation of section 53.4941(d)-2(f)(2).

#### HOLDING

The loan program of a private foundation that provides financing to publicly supported organizations described in section 170(b)(1)(A)(vi) of the Code for construction projects in disadvantaged areas does not result in acts of self-dealing within the meaning of section 4941 merely because contractors and subcontractors involved have ordinary banking and business relationships with a bank that is a disqualified person with respect to such foundation.